High Prices in Japan

Various reports catalog the high cost of living in Japan. The Organization for Economic Cooperation and Development gives an analysis based on direct observation and purchasing power parity, the most commonly used basis for comparing prices around the world. Before the September 1985 Plaza Accord realigned major international currencies, Japan's purchasing power parity of Y218 was not that much different from the Y239=$1.00 exchange rate. In 1988, however, purchasing power parity indicated that Y201 was needed to buy $1 worth of goods, yet the average exchange rate for the year was Y128=$1.00. On this basis, at least, prices in Japan were 57 percent higher than in the United States.

The Economic Planning Agency's November 1988 international comparison of the prices of various products and services gives more direct information. EPA's investigation revealed that the relative price of food in New York City was 69, setting Tokyo prices equal to 100 at the average 1988 exchange rate of Y128.15=$1.00. New York City durable goods rated a 76, clothing and footwear 67, utilities and water 44, transportation and communications 70 and rental housing 54. The average New York City price level was 72, which implies that Tokyo prices were 38.9 percent higher. Only medical services and education cost less in Tokyo (see Table 1).

Table 1: Relative Prices in New York and Hamburg, West Germany, November 1988

(Tokyo = 100)

	New York	Hamburg
Average	72	68
Food	69	64
Durable Goods	76	88
Clothing and Footwear	67	71
Other Products	79	89
Utilities and Water	44	70
Transportation	70	93
Health Care	106	24
Education	108	52
Rental Housing	54	51
Other Services	118	78

Source: Economic Planning Agency, Price Report 1989.

An October 1989 report by a Japanese business organization revealed the same facts. The Japan Committee for Economic Development (Keizai Doyukai) study compared the prices of frequently purchased products in Tokyo to those in New York City, London and other major foreign cities. Nineteen of the 39 products

The JEI REPORT (ISSN 0744-6489) is published weekly except for the New Year, Memorial Day, Labor Day, Thanksgiving and Christmas holiday weeks for $40 per year by the Japan Economic Institute of America, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036. Second class postage paid at Washington, D.C. POSTMASTERS: Send address changes to JEI REPORT, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036.

investigated cost more in Tokyo; in particular, 17 food items were 30 percent costlier than in New York City or Los Angeles.

Surveys by major newspapers and business magazines have found the same results, as has a recent widely publicized joint survey by the Ministry of International Trade and Industry and the Department of Commerce (to be discussed in detail below). There is no doubt that the prices for many goods are higher in Japan, particularly in Tokyo, than in other industrial countries. No one reason, however, explains the gap across-the-board.

Public Services

In the case of public services, among the main causes of high prices are the need to borrow large amounts of money, strict environmental regulations and, as in other countries, limited competition. Here are some examples:

• Utilities - The need to raise large amounts of funds in addition to the use of depreciation and retained earnings significantly affect electricity charges. According to EPA's November 1988 pricing study, electricity prices in Japan, based on Tokyo Electric Power Co., Inc. rates, came to Y20.33 ($0.145 at Y140=$1.00) per kilowatt-hour, 40.4 percent higher than the equivalent Y14.48 ($0.103) charged by New York's Consolidated Edison Co. Depreciation and interest charges accounted for 32 percent of TEPCO's total costs in contrast to 10 percent for ConEd. These costs are necessary to meet the increasing demand for electricity in Japan and the country's strict environmental and safety regulations for power plants. Moreover, TEPCO's average fuel costs -- Y5.25 ($.038) per kwh -- were 54 percent higher than ConEd's, according to the EPA study. This cost of inputs is a key component of Japan's high-cost structure.

For much the same reasons that electricity costs more in Japan than here, Japanese prices for natural gas are almost double those in America. In addition, though, Japanese suppliers have to bear an incremental charge for importing liquefied natural gas by ship and converting it back to natural gas for home and industrial use. Furthermore, since the ratio of business-related use to total gas consumption (19.8 percent) and average gas sales per consumer (7.6 million calories per year) are much smaller than in the United States (25.7 percent and 27.5 million calories, respectively), economies of scale are difficult to fully achieve.

• Telecommunications - After Nippon Telegraph and Telephone Public Corp. was privatized and the domestic telecommunications market deregulated in April 1985, telephone charges in Japan fell (see JEI Report No. 46A, December 8, 1989). Yet a price gap between there and the United States still exists for long-distance calls. A comparison of basic home service in both countries shows that local calls in Tokyo -- Y10 ($.07) for a three-minute call -- cost a little bit less than in New York -- Y12 ($.08) for an unlimited call. However, a long-distance caller in Japan pays Y330 ($2.36) for a three-minute, 200-mile call, while a similar long-distance call made from New York City might cost about Y112 ($.80). This gap can be traced back to the Ministry of Posts and Telecommunications and how it sets rates for NTT and, by extension, for NTT's three competitors in the domestic long-distance market.

Service Sector

During the 1980s the most frequently heard economic catchphrase in Japan was deregulation. In response to recommendations by an advisory panel on

administrative reform established in 1980, the Japanese government deregulated the domestic telecommunications market and privatized NTT, reorganized the Japanese National Railways into eight separate private corporations and allowed more competition in the domestic and the international air travel markets. In spite of these actions Japan still has been named "The Kingdom of Regulation" by Professor Toshimasa Tsuruta of Senshu University. A recent study, titled "Reviewing Governmental Regulations from the Standpoint of Competition Policy," done by a Fair Trade Commission group chaired by Mr. Tsuruta, described various government regulations that protect service industries.

This study used 1985 input-output tables as a basis of calculating the ratio of value added in a government-regulated sector to the value added by each industry. It then added the regulated share of each sector to achieve an overall sum of 40.8 percent of the overall economy in 1988. Of the regulated industries, 59.1 percent -- or 24.1 percent of the whole economy -- was considered strongly regulated because of entry barriers or price controls. Mining, construction, finance and electric and gas utilities are completely regulated, according to this study's calculations. Furthermore, 95.3 percent of transportation and communications, 85.8 percent of agriculture, forestry and fisheries and 58.4 percent of other service industries, such as wholesale and retail trade, are regulated. In contrast, 16.8 percent of manufacturing and 3.6 percent of real estate received this designation (see Table 2).

Table 2: Role of Regulated Sector in Japan's Economy, 1988

(percent of gross national product)

Industry	Value Added Contribution to GNP	Share of Regulated Sector	Share of Strongly Regulated Sector
Agriculture, Forestry and Fisheries	3.0%	2.6%	1.7%
Mining	0.3	0.3	0.2
Construction	7.2	7.2	0.0
Manufacturing	28.0	4.7	2.8
Wholesale and Retail Trade	12.4	n.a.	n.a.
Banking and Insurance	5.5	5.5	5.5
Real Estate	9.5	0.3	0.3
Transportation and Communications	6.5	6.2	5.9
Electricity and Gas	2.9	2.9	2.9
Services	20.5	11.2	4.9
Public Sector	3.6	0.0	0.0
Other	0.7	0.0	0.0
Total	100.0	40.8	24.1

Source: Fair Trade Commission, "Reviewing Governmental Regulation from Standpoint of Competition Policy," 1989.

The official explanation for the regulations is that they secure "fair" competition. On paper they are designed to benefit consumers. In reality,

though, the regulations protect established business interests by restricting competition.

Examples of regulatory overkill abound. A bus company must notify the central government about its office locations, parking spaces and the stops on each route as well as the number of buses, carrying capacities and the timetables of each operation; the firm also must submit an application to Tokyo whenever it wants to change the location of a stop in a rural area 500 miles away from Tokyo or on the island of Okinawa. A taxi operator must be in a specific age range and have a number of years of experience in this industry.

The government cites a need to match supply with forecasted demand as its reason for regulating entry to the trucking, bus, taxi and airline businesses plus liquor sales, banking and securities. Furthermore, new competitors must coordinate with existing local operators in the trucking business, liquor sales and big retail stores (see JEI Report No. 43A, November 10, 1989) before they can set up shop. Property insurers need 26 permits. Although interest rates on certain instruments over Y10 million ($71,429) were deregulated in 1988, interest rates on many types of deposits still are regulated by the Ministry of Finance. These and similar types of regulations stifle competition, delay innovation, paralyze the market mechanism and thus result in high prices.

Another reflection of the service industry's overprotection is its relatively low labor productivity. Setting 1985 U.S. productivity rates at 100, relative productivity in Japan was 80.9 in wholesale and retail trade, 57.5 in transportation and communications and 90.6 in other services. Service industries also recorded lower rates of productivity growth compared to manufacturing from 1975 to 1985. Over this period output per worker in the manufacturing sector jumped 95.8 percent. In services, though, the comparable figures were 41 percent for the electricity, gas and water industry, 57.9 percent for wholesale and retail trade, 28 percent for transportation and communications businesses, 26.6 percent in the finance field and 15.3 percent for other services.

Import Restrictions

As in other countries, protection from import competition in Japan takes the form of border measures -- tariffs, quotas, variable levies and state trading -- and budgetary and other direct subsidy programs, such as price supports. To determine the impact of exchange rate changes between 1985 and 1988 on domestic wholesale prices, the Economic Planning Agency last year compared the prices of 14 protected items -- powdered milk, sugar, cheese, wheat, beef, pork, leaf tobacco, cigarettes, whiskey, wine, brandy, silk, steam coal and coking coal -- to those of 66 unrestricted products. EPA's study indicated that wholesale prices for the 14 products remained unchanged through the 1985-88 period despite a 25 to 30 percent reduction in import prices. Conversely, wholesale prices for the unregulated products fell about 20 percent in parallel with a reduction of about 25 percent in import prices. For agricultural goods these results imply that agricultural import restrictions are one of the main causes of the high price of food in Japan.

A study published by the Bank of Japan in December contained similar results. BOJ examined 13 of the 14 regulated products (cigarettes were the exception) investigated by EPA, calculating wholesale and import prices in July 1989. Using 1985 as 100, average import prices on the regulated items declined

to 70.6 but average wholesale prices rose to 102.8. Through the same period wholesale prices for the surveyed unregulated products -- such as cement, steel, nonferrous metals, cotton and electrical goods -- declined and lowered the overall wholesale price index by 2 percent. BOJ's report, which said regulated products make up 18 percent of the WPI and 28 percent of the consumer price index, indicated that average wholesale prices could be reduced 3 percent if all import restrictions, including the sole-agent import system and administrative guidance on home kerosene prices, were removed.

Tradable and Deregulated Products

A price study of 20 foreign brand name products (handbags, perfume, whiskey and brandy) done by the Tokyo metropolitan government last August, found 14 were priced higher in Tokyo than in other major cities, such as London, Paris, Milan and Hong Kong. The study also found that Japanese retail prices for the imported products were three to seven times higher than the landed prices of the foreign merchandise. This meant that the import price accounted for only 15 percent of the final cost for French-made perfume, 20 to 25 percent for Scotch and bourbon whiskey and 31 percent for French- or Italian-made handbags. These results suggest not only that distribution margins in Japan may in some instances be large but that substantial price differentials may exist for tradable products between Japan and its foreign suppliers.

The Ministry of International Trade and Industry and the Department of Commerce carried out the most extensive study yet on the price differences among tradable goods in October 1989. The results were released in conjunction with the second round of the Structural Impediments Initiative talks in November. Surveying the prices of 122 products in New York City, Chicago, Tokyo and Osaka and using Y142=$1.00 as the exchange rate, investigators found that 84 of the items were more expensive in Japan than in the United States while the reverse was true for 38 goods -- a 2-to-1 ratio. The sampled products included 23 made in Europe; of these 22 sold for more in Japan than in the United States. This implies that the distribution system is the main reason for the higher prices of European goods in Japan. The sole-agent import system and the prestige of European makers, which lets distributors mark up prices, contribute to the problem in Japan, where brand name products, such as Gucci, Yves Saint Laurent and Burberry, find a comfortable niche in a huge gift market.

The causes of the pricing differentials for the surveyed American- and Japanese-made products are not as clear-cut. In early November testimony before the Senate Finance Committee's subcommittee on international trade, Robert Lawrence, senior fellow at the Brookings Institution, said his analysis of distribution margins indicated that Japanese manufacturers, not distributors, are responsible for Japan's high prices. He noted as well that Japanese export and domestic prices vary. This suggests that Japanese producers engage in price discrimination, maintaining prices at home higher than elsewhere.

In the MITI-DOC price study 50 of the 122 products surveyed were made in Japan (see Table 3). Of these 21 (42 percent) were priced higher in Japan than in the United States. That leaves 29 of the Japanese-manufactured products (58 percent) selling for less in Japan. Therefore, the study shows that not every manufactured good is relatively more expensive in Japan. However, of the 35 products made in America and included in the study, 31 (88.6 percent) were cheaper in this country than in Japan. The big difference between this figure

Table 3: Japan-U.S. Retail Price Comparisons, 1989

(number of products)

	Made in Japan	Price Higher in Japan	Made in United States	Price Higher in United States
Cars	2	1	2	0
Automotive Parts	4	3	1	0
Consumer Electronics	27	9	3	1
Food Products	4	3	10	0
Miscellaneous Consumer Goods	2	0	15	2
Scientific and Medical Equipment	11	5	4	1
Total	50	21	35	4

Notes: Study conducted in New York City, Chicago, Tokyo and Osaka. An exchange rate of Y142=$1.00 was used. The following products were surveyed:

Automotive parts - tires and spark plugs.
Consumer electronics - electric shavers, cameras, camera lens, film, calculators, laser printers, microwave ovens, video cameras, videocassette recorders, portable compact disk players, audio tape, cordless telephones and batteries.
Food products - ketchup, breakfast cereals, jam and chocolate.
Miscellaneous consumer goods - beer, wine, sake, whiskey, cigarettes, bed linens, men's blue jeans, china tea cups and saucers, fragrances, golf balls, golf clubs, stationery, pens, eye drops and movie tickets.
Scientific and medical equipment - dental casting machines, porcelain dental furnaces, digital storage oscilloscopes, spectrophotometer and liquid chromatograph.

Source: Department of Commerce and Ministry of International Trade and Industry, November 1989.

and the comparable number of 58 percent for Japan implies that more forces are at work in Japan pushing up prices.

Several possibilities might explain the difference. Mr. Lawrence has hypothesized that widespread adherence in Japan to manufacturers' suggested retail prices is responsible. Others blame the discriminatory pricing (dumping) strategy of Japanese exporters interested in gaining market share abroad. Others cite the slowness of exporters to increase prices on U.S.-bound exports in response to the weaker dollar. Other structural factors, such as Japan's fairly steep corporate taxes, the high cost of land and the distribution system, each have their advocates.

It is unlikely that dumping explains the overall price differential; in any case, dumping calculations are not based on retail prices. Slow adjustment to exchange rate changes also cannot be an across-the-board answer because 14 months already have passed since the dollar recorded its lowest level of Y120

in November 1988. Some structural factors, such as high land prices in Tokyo or the multilayered distribution system, certainly have inflated Japanese prices. Yet it is hard to believe that Japan's higher prices are caused solely by them.

As far as manufacturers having a strong hand in retail price-setting, there are some reports of episodes in which a Japanese manufacturer threatened retaliation against a deep discounter, a factor considered by some to have a significant influence on price determination at the retail level. However, these reports are supplied by newspapers as anecdotal evidence and lack an objective estimate of how manufacturers have affected retail pricing.

Even if manufacturers in Japan are able to exert more influence on retail prices than their American counterparts, this development has limited explanatory power for the high domestic prices. In Japan's consumer price index products supplied by big businesses account for only 19.4 percent by weight of the goods and services making up the index -- higher than the 11.5 percent for agricultural products but a little bit less than the 20.6 percent for the output of small producers and much less than the 42 percent assigned to services. Therefore, the high prices of certain manufactured goods can be reduced to some extent by removing the influence of manufacturers on retail price-setting, but that still would not do much to lower the overall price level in Japan.

Other Structural Factors

Consumer Behavior - An abundance of anecdotal evidence shows the irrational behavior of many Japanese consumers. When a well-known Japanese department store, for example, decided to sell foreign-brand goods at a discount, sales plunged. On the next day, when the store relabeled the merchandise and doubled the price, all the goods on the shelves sold that day. Many analysts suggest that Japanese consumers themselves are responsible for the high prices of some products. In such cases, consumers with discriminating taste apparently lack discrimination in pricing.

Gift Market - Japan has a huge gift market based on traditions in both personal and business relationships. A gift is regarded as an honorarium-in-kind for business clients, persons of senior status and go-betweens in arranged marriages. The price of a gift usually is considered much more important than the kind of gift. A year ago a prestigious Y5,000 ($36) bottle of whiskey made by Japanese distillers was a typical gift. However, once the price was decreased 25 percent in response to cuts in Japan's liquor taxes, gift sales of this whiskey slipped, and demand shifted to a more "prestigious" whiskey, which was newly priced at Y5,000. The Japan Economic Journal estimates that Japan's gift market now is valued at Y12.7 trillion ($90.7 billion), larger than the Y10 trillion ($71.4 billion) in total sales by department stores. The gift market is expected to expand to Y20 trillion ($142.9 billion) in five years.

Corporate Consumption - Since personal, long-term relations are considered a key to business success in Japan, substantial corporate entertainment expenses, even though they are taxed completely for large corporations, are necessary, an indication of sincerity toward the business client. To invite clients to an expensive weekend golf outing or gourmet dinner at a cozy Japanese or French restaurant are two of the most popular types of corporate entertainment. Similar to the gift, the higher the cost, the higher the esteem. This allows clients and companies to judge how eager each is to do business.

Japanese tax authorities revealed that total entertainment costs reached nearly Y4.6 trillion ($32.5 billion) in 1988, an increase of 8.3 percent. This figure is said to be almost three times higher than in the United States and 14 times greater than the number for Great Britain. Corporate consumption increases prices in two ways: the ripple effects caused by a business paying high prices for costly products and the higher charges for its product or service to cover the huge expenditures needed for entertainment.

Other Factors - For some products fixed retail sales prices are set legally. This action does not violate antitrust law in Japan under a provision called the resale price maintenance contract, which has no U.S. counterpart. The covered products include 2,417 cosmetics and 201 pharmaceutical products, books, magazines, newspapers and records. The purpose of this contract is said to be to prohibit companies from predatory pricing of goods that are copyrighted or have a close relation to health. However, such relatively new products as videotapes, cassette tapes, compact disks and computer programs are not subject to this contract despite the fact that they have the same type of copyright protection. Therefore, it does not make any economic sense for only books and the other items listed to be protected from the standpoint of fair competition. Rather, historical factors have tended to keep the monopolistic interests alive.

Japanese retail stores have been accused of tending to avoid competition on the basis of prices by tacitly agreeing with neighboring stores to set a uniform price. A recent reported example is that of a major discount chain selling cameras and videocassette recorders that was forced by small local retail stores to promise not to reduce the price of a new camera when it opened an outlet in a popular shopping area of Shibuya in Tokyo. The end result is that the small retail stores continue in business while the discount store accrues bigger profits by raising its normal prices. The consumer loses most. This situation has led consumer activitists and others to call for strengthened implementation of Japan's antimonopoly law.

The Japanese distribution system with its multilayered structure, product-return option, sole-agent import system and large-scale retail store law also has affected and sustained high prices in Japan (see JEI Report No. 43A, November 12, 1989). High land prices are also a key factor boosting prices, in particular in Tokyo (see JEI Report No. 39B, October 13, 1989).

Conclusion

Japanese prices are high for a variety of historical reasons, none of which apply as a single explanation common to all products. However, based on an analysis by sector, it is possible to make some proposals that could reduce prices in each. Extensive borrowing requirements, scarce resources and, in some instances, limited economies of scale are the main reasons for the high prices of public services. Therefore, to reduce prices, industries in this category should seek ways of conserving on capital expenditures, finding inexpensive alternative natural resources and achieving production efficiencies. Competition, too, could reduce prices, as long as the industries meet public expectations for stable supplies.

Concerning the service sector and imports, high prices appear to be the direct result of excessive government regulations. Therefore, deregulation

could help to decrease prices. It will be just a matter of time before discussions begin on whether current regulations should be maintained or how fast they can be altered.

Even in deregulated industries, there is evidence implying that stronger implementation of the antimonopoly law or efforts to promote competition are effective ways to lower the tags of some pricey manufactured goods. High land prices and other structural factors also appear to keep prices high. Their impact, too, could be lessened to some extent by deregulation because they are historical products of past governmental regulations. Therefore, the key to altering Japan's high price structure lies in how fast the government deregulates the economy and allows the market to arbitrate prices.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.